44-SBE-027

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

SAN DIEGO FRUIT & PRODUCE COMPANY)

Appearances:

For Appellant: Raymond M. Wansley, Certified Public Accountant.
For.Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; James J. Arditto, Franchise Tax Counsel.

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of San Diego Fruit & Produce Company to a proposed assessment of additional tax in the amount of $211.28 for the taxable year ended December 31, 1938.

Appellant, a California corporation, conducts farming operations in the States of California, Idaho, Utah and New Mexico and in the Republic of Mexico. The products raised outside of California are sold only outside the State and the major portion of the products grown in California is sold in other states.

Separate records are maintained by Appellant of its receipts and direct expenses in and outside the State. General administrative expenses are apportioned to income earned within and without the State on the basis of gross receipts. For the income year 1937 Appellant filed its franchise tax return showing a loss of $14,428.88 from operations in California, notwithstanding that it earned a total net income of $8,475.12 from all its operations both within and without the State. The Commissioner declined to accept Appellant's separate method of accounting as correctly determining income from business carried on in California and proposed a deficiency assessment using the three-factor formula of sales, payroll and property to allocate a portion of its total net income from all sources to this State.

Appellant contends that its separate method of accounting accurately determines the amount of its income or loss from California business and that the use of the formula apportions to California income earned outside the State. This appeal, accordingly, presents the same general question as was involved in Butler Brothers v. McColgan, 315 U. S. 501, that is, whether the Commissioner is warranted in using the formula for the allocation of income or whether the Appellant is entitled to use the separate

accounting of its California operations to determine its net income in this State.

The profits of a unitary business conducted in several states are derived from a series of transactions taking place both within and without a particular jurisidction. It is difficult by separate accounting to allocate accurately the profits earned by the activities conducted within the borders of any one state. Accounts may show the amount of profits but they do not necessarily show whence they came. Section 10 of the Bank and Corporation Franchise Tax Act authorizes the Commissioner to determine through the use of an allocation formula the income attributable to California Of a corporation doing business within and without the State.

The use by the Commissioner of a sales, property and Payroll formula in the case of a unitary business carried on in California and other states, even though the taxpayer had maintained a separate accounting system for its California operations, was sustained in the Butler Brothers case. The Court stated therein that "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed," 315 U. S. 501, 507.

Here, as was contended in the Butler Brothers case, it is argued that the taxpayer's business within the State can be segregated from that without the State and that the separate system of accounting more accurately determines the net income from California business than does the method used by the Commissioner. In support of this position and to meet the burden of proof resting upon it under that case, the Appellant has submitted a statement termed "Segregation of Operations for Income Year Ended 12-31-1937. In this statement are set forth in summary form the various classes of gross income and of deductions, in each case the "Total," the "California" portion and the "Outside of California" portion being shown.

The statement does not, however, establish, in our opinion, by "Clear and cogent evidence" the soundness of Appellant's position, In the first place, it is to be observed that the segregation does not purport to be complete since expenses of $64,333.55, comprising about ten per cent of the total expenses, are prorated on the basis of the California gross receipts of $178,233.56 and out of State gross receipts of $471,762.07. Of a total depreciation deduction of $25,128.20, $20,955.35 is allocated to California No explanation is made of the method of allocation. For all that appears, accordingly, the California portion may include depreciation on buildings located in this State but not devoted entirely to California operations, as, for example, a general office building, devoted to operations both within and without the State. Similar observations may be made as respects the deduction for taxes paid of $2,240.37, of which $1,702.70 is allocated to California, and as respects that for rent of $1,345, of which $1,320 is allocated to this State.

Attention might also be directed to other considerations, as, for example, the fact that the statement does not negate the view

implicit in the Commissioner's use of the formula that the unity of ownership and management of Appellant's properties within and without the State contributed to the net income arising from the conduct of the unitary business. It sufficiently appears in our opinion from the foregoing, however,, that the Appellant has not clearly established that the application of the allocation formula resulted in the taxation by this State of extraterritorial values.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, overruling the protest of San Diego Fruit and Produce Company to a proposed assessment of additional tax in the amount of $211.28 for the taxable year ended December 31, 1938, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustained.

Done at Sacramento, California, this 19th day of July, 1944, by the State Board of Equalization.

R. E. Collins, Chairman
Wm. G. Bonelli, Member
J. H. Quinn, Member

ATTEST: Dixwell L. Pierce, Secretary